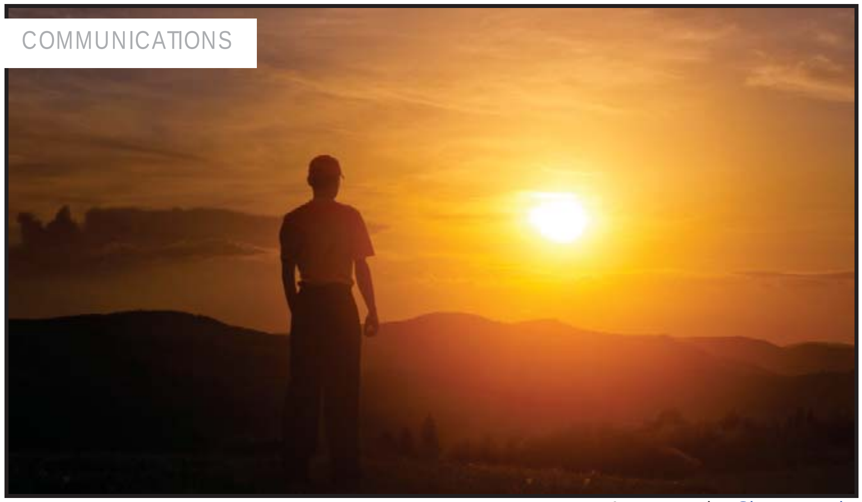
Markets, regulation, autonomy, and dignity

by: Gus Hurwitz

March 14, 2014 6:00 am

COMMUNICATIONS



Autonomy by Shutterstock

tags: Comcast, M&A, Netflix

Following news of the proposed Comcast/Time Warner Cable merger and the Comcast/Netflix interconnection agreement, the tone of telecom and tech policy discussions has fallen precipitously. Most commentary about these deals has been immediate and reflexively hostile – based in emotion and fear rather than in facts. This response is frustrating to watch – though at some level it has been a return to normal, following a few months of atypically reasonable discussion leading up to the DC Circuit's Network Neutrality decision.

At its core, the response to these deals reflects popular anti-market, pro-regulatory, sentiment. I would like to spend some time thinking about these attitudes. Perhaps surprisingly, I find them quite sympathetic – the pro-regulatory view is intuitively appealing and at some level a reasonable one to hold. While I disagree with it, it is important to understand why this view is so durable.

The individual is central to competing views about regulation and the market. Market-oriented advocates generally view the market as respecting and promoting individual autonomy and dignity – and they fear that regulation robs individuals of this dignity, denying them their basic freedoms of association and conscience. Advocates for stronger regulation generally have the opposite perspective, distrusting markets and fearing that they treat individuals as commodities, robbing them of same dignity that market-oriented thinkers seek to protect. The pro-regulatory view sees regulation as a way preserve individuals' dignity against a hostile market.

Which view is right? The answer, of course, is both – for reasons that I believe are particularly important for free-market advocates to understand. If the free-market view is to be internally consistent, its advocates need not only to focus on why they are right, but also to respect why its detractors are not wrong. The discussion below proceeds in four parts: an explanation of the market-oriented view; discussion of what that view overlooks, and why this supports the idea that markets do not support individual autonomy; the economist's response to this accusation; and the need for market-oriented thinkers to be responsive to these concerns.

Part I: The market-oriented view – Complexity and the mysterious invisible hand

I fall into the school of economic thought that emphasizes economics as the science of self-interest and mutually beneficial exchange. Broadly speaking, individuals make decisions that make themselves better off – this means that any agreement between multiple parties must make each party to the agreement better off. Certainly there are cases where this isn't true – most classically in cases of monopoly and diffuse negative externalities (e.g., pollution). But by and large, arguing from both theory and empirics, the moral case for free-market economies is strong. (See, for instance, Alex Tabarrok's discussion of economists as leading opponents of slavery, Mill's classic argument for equality between the sexes, and Deirdre McCloskey's recent exploration of the question "Are Market's Moral?")

Markets certainly are not perfect. No market is perfectly efficient; few markets come anywhere near the ideal of perfect competition. It is the great failure of contemporary undergraduate economics education that most students come away believing that perfect competition is an assumption of economics. (Indeed, the first task of graduate-level economics education is to break down the undergraduate-level caricatured understanding of economics.)

But economics educators use this approach for a reason: the operation of economics is confoundingly complicated. As Hayek famously explains, "The curious task of economics is to demonstrate to men how little they really know about what they imagine they can design." The challenge of this task is that the functioning of markets is overwhelmingly complex, and the apparent problems with them are so patently obvious. Anyone who has ever felt they have paid too much for some good or service has identified what they view to be a problem with the market (the market's price was too high!), and the solution to this problem is maddeningly obvious (the government should require lower prices). It generally takes years of graduate level study to develop an intuitive sense that interactions between billions of individuals gives rise to a coherent and beneficial market – one guided by Smith's invisible hand – and to overcome the natural tendency to view so many market-based interactions as unfair.

Part II: What the market-oriented view forgets

This is where we find that the motivation for the regulatory approach is also based in concerns for individual autonomy, respect, and dignity.

It is often forgotten that, on the same page as he invokes the invisible hand, Smith also notes that "it is the maxim of every prudent [individual] never to attempt to make at home what it will cost him more to make than to buy." This is the basic mechanism animating the invisible hand – it is the same as my initial explanation of mutually beneficial exchange. Individuals only enter into agreements that make them better off as compared to their next best alternative.

But there is an assumption built into Smith's prudent individual's "make or buy" decision: that individual needs to know how much it will cost to make a good compared to buying it. An initial assessment of his ability to do this underlines the pro-regulatory concern that markets rob individuals of their autonomy: few people know how much it would cost to build a telecommunications network; and few trust that the market prices for telecommunications service are fair. And it is perfectly reasonable that they don't trust the market prices: just as they don't know how much it would cost to construct their own network, they lack a baseline price against which to compare the market price. Thus, they are forced to accept a price that they do not trust because they lack – and cannot reasonably be expected to have – the facts needed to make an informed decision.

This view is captured in Brian Fung's recent article on the Comcast-Netflix deal: "The central problem here is a lack of information. We don't know how Comcast's deal with Netflix is structured and how much money is changing hands. That makes it hard to judge whether critics are right when they claim Comcast is engaging in anticompetitive business practices. And it makes it hard to know whether consumers will wind up paying more as a result of the deal. We could fix this by having the government require Comcast to be more forthcoming about its Netflix relationship."

Part III: The economist strike back

The economist's response to this is that the relevant parties – Comcast and Netflix – have excellent understandings of the underlying "make or buy" decision. Netflix had been self-provisioning its content distribution (i.e., "making" it), but had the opportunity to enter a better deal with Comcast to buy content distribution. There may be a possibility that the parties have entered a deal that is harmful to consumers – but this is why we have the FCC and DOJ. It is almost a foregone conclusion that both agencies had copies of the agreement between Comcast and Netflix within hours of the deal being announced.

More generally, the economist's response to the concern that Smith's "make or buy" decision forces individuals to choose between something they don't understand and something they don't trust is that both questions are answered by the market. The market price for a given good or service provides a first approximation of the cost of making that good or service. This is true even if the vast majority of market participants don't know enough to make the make or buy decision. So long as some (relatively small) portion of the market has a sense of these costs, competition – that is, everyone else in the market, each with their own specialized knowledge, making the same make-or-buy decision – will ensure that market prices reflect cost.

The economist will also say that we must look at the other side of the equation. Just as the individual must choose between making and buying, society must choose between competition and regulation – and must recognize that neither is costless. Just as there is no such thing as perfect competition, there is no such thing as costless or perfect regulation. To the contrary, the history of regulation is fraught with failure. As discussed by Ronald Coase in a 1997interview:

> When I was editor of The Journal of Law and Economics, we published a whole series of studies of regulation and its effects. Almost all the studies – perhaps all the studies – suggested that the results of regulation had been bad, that the prices were higher, that the product was worse adapted to the needs of consumers, than it otherwise would have been. … I can't remember one that's good. Regulation of transport, regulation of agriculture – agriculture is a, zoning is z. You know, you go from a to z, they are all bad. There were so many studies, and the result was quite universal: The effects were bad.

Part IV: What must economists do?

The challenge that we – those of us who believe in the economic and free-market approach to regulation – face is that laid out by Smith, Hayek, and Coase. Our task is to explain on the one hand that despite its near-impenetrable complexities, the market tends to present individuals with a reasonable "make or buy" decision, and to explain on the other hand that despite regulation's self-evident simplicity its actual practice is fraught with failure. The market, though it often does not *feel* this way, treats individuals with dignity, respecting and promoting their autonomy; regulation, though often crafted with the purpose of treating individuals with dignity, often works to frustrate and limit individual autonomy.

If we ignore this task and instead argue on the substance of specific cases and policies, we will always lose the public case for sound policy. Sound policy may nonetheless emerge from serious and deliberative decision-makers, such as judges and those at the DOJ, FTC, and FCC. But so long as the common view favors regulation and distrusts the market, policy debates are a war of attrition.

The tenor of the Comcast/Time Warner Cable merger and Comcast/Netflix deal coverage has been a stark reminder that the discussions by those who understand these issues are driven by the concerns of those who don't. And it is no response at all to say that the average individual should know more. They shouldn't – they should know enough to trust the market in the abstract, so that they can focus their own efforts on developing specialties that will make the market work for others. The winning appeal to the public is that of dignity, of the market's power to protect and promote the interests of the individual – of all individuals – and of the counter-intuitive dangers that regulation poses to it.